January 2012

• In December, the jobless rate in Texas fell to 7.8% - its lowest level since July 2009.
• Texas saw higher home sales and property prices in 2011.
• Texas factory activity strengthened in January.
• The U.S. economy picked up speed in the last quarter of 2011.

Executive summary

2012 started on an optimistic note – factory activity in Texas strengthened in January, following somewhat weaker performance at the end of 2011. Equally important, this uptick of local business activity mirrors the improved economic situation nationwide as manufacturing in other large states also increased. The most recent national surveys of the manufacturing and service industries indicate economic growth is regaining the momentum last seen during the initial phases of the recovery.

Several factors stand behind this more upbeat economic data. First, new orders of durable goods jumped at the end of 2011 thanks to growing orders for capital goods and, in particular, surging new orders of civilian aircraft and parts. In addition, solid growth of business sales added momentum to inventory restocking, which helped sustain demand for manufactured goods. Meanwhile, the jobs picture has steadily improved with falling initial jobless claims and a pick-up in private sector hiring. This couple with a resumption of bank lending to consumers boosted retail sales (particularly car sales). These trends, as well as the recent gain in consumer sentiment, may be the first positive signs of a national economy moving closer to a self-sustained recovery underpinned by resilient consumer spending and faster jobs growth.

Indeed, stronger consumer spending helped the U.S. economy pick up speed in the last quarter of 2011. In particular, personal consumption was the second largest contributor (after private inventories) to economic growth, pushing GDP growth to its strongest pace since the second quarter of 2010. A sizable increase in inventories, however, may raise some concerns over the near-term outlook. That being said, recent reports from the U.S. Census Bureau and the Institute for Supply Management do not seem to raise any red flags – businesses are still running lean on inventory. Thus, companies appear to be building up stocks as a response to stronger demand, rather than lagging sales.

However, the slower growth in business spending in the last quarter of 2011 may be a bigger challenge to any nascent economic recovery. An opaque economic outlook still makes many companies hoard rather than invest their record high earnings. Although Eurozone debt problems (as well as worries over the strength of some emerging markets) add to this uncertainty, domestic policy issues still remain the major concern. Indeed, a ‘hostile’ regulatory climate and political gridlock in Washington continue to unsettle investors. Meanwhile, this year policymakers face a menu of difficult choices, which, considering a divided government and election paralysis, leaves little hope for bipartisan solutions and is likely to keep policy uncertainties at an elevated level.

In December, the Texas jobless rate fell to its lowest level since July 2009, which is impressive given the backdrop of an over 7% growth in the Texas labor force since the start of the recession. This faster growing workforce is a result of both rapid population growth and a healthier labor market, which make Texans relatively more successful in seeking employment. Nonfarm employment in Texas has already surpassed its pre-crisis peak (while there are still nearly 6 million fewer nonfarm jobs nationwide).

The strength of the local Texas labor market is partly due to high energy prices - Texas currently has the most mining jobs in over two decades. Yet mining jobs are just one part of the Texas labor market recovery, with solid job growth observable across most private industries. More specifically, there have been relatively smaller losses in construction and manufacturing jobs in Texas compared to other large states, thanks to less exposure to the residential construction industry. Meanwhile, manufacturing jobs in Texas were less impacted by sagging national demand for vehicles and also enjoyed a greater rebound in overseas shipments of machinery and computers. In addition, the state’s manufacturers of nondurable goods were helped by strength in the Texas petrochemical industry as well as a small share of jobs in the declining textile sector.

Lastly, the Texas labor market is enjoying a broad-based rebound in service-providing jobs, unlike the nation as a whole; the state now has more private sector service-providing jobs than at the start of the recession. Faster population growth in Texas and an aging population are driving demand for healthcare services. Meanwhile, hiring in finance and professional and business services remains strong thanks to a robust uptick in overall business activity. Since approximately one in five private sector jobs in Texas is either in finance or professional and business services, this trend is yet another sign that the regional economic recovery is on the right path.
Economic output

Texas factory activity strengthened in January as the current production index of the Texas Manufacturing Outlook Survey moved back into positive territory (see chart 1). Most of the other gauges of manufacturing conditions – from new orders to capacity utilization – improved as well, pointing to a solid uptick in the local economy. Equally important, both current and future measures of general business activity and company outlook moved up, which means that businesses grew more optimistic about broader economic conditions in the state. On that note, stronger business activity in Texas reflects the improved economic situation nationwide, as factory activity in other big manufacturing states also increased during the first month of 2012 (see chart 2). In particular, the National Purchasing Managers Index rose to 54.1 in January, implying that U.S. factory activity grew at the fastest rate since June 2010.

Several factors stand behind this brighter outlook. First, new orders of durable goods jumped at the end of 2011 thanks to growing new orders of capital goods (see chart 3) and, in particular, new orders for non-defense aircraft and parts, which at $19.5 billion in December hit their highest level in six years. As a result, new orders of non-defense aircraft and parts surged by 54% last year. Meanwhile, recovering business sales added momentum to inventory restocking, which helped sustain demand for manufactured goods as well (see chart 4). Second, a better jobs picture, and a resumption of bank lending to consumers (see chart 5), boosted retail sales and, in particular, car sales (see chart 6). These trends and a recent gain in consumer sentiment (see chart 7) may be a positive sign of the national economy moving closer to a self-sustained recovery underpinned by resilient consumer spending and faster jobs growth. For example, in January, total light vehicles sales stood at a seasonally adjusted annual rate of over 14 million units – up by over 11% versus a year ago and at their highest level since mid-2008. One possible reason for growing car sales is that the average age of the passenger car fleet in the U.S. reached an all-time high of nearly 11 years. Steady jobs growth should make Americans more confident to replace old cars kept since the downturn.

Consumer spending on motor vehicles and parts contributed over 1.1 percentage points to the 2% growth in personal consumption in the last quarter of 2011. As a result, personal consumption was the second biggest contributor (after private inventories) to economic growth in the fourth quarter of 2011, when GDP grew at an annualized rate of 2.8%, the strongest expansion since the second quarter of 2010 (see chart 8). The composition of growth, however, raises some concerns in the near-term. Firstly, inventories added nearly 2 percentage points to overall GDP growth. This inventory buildup may detract from future GDP growth if demand becomes weaker than expected. On the upside, recent reports from the U.S. Census Bureau and the Institute for Supply Management do not seem to raise any red flags – businesses are still running lean on inventory, while inventories/sales ratios remain at historically low levels. It would appear businesses are increasing their inventories in response to stronger demand rather than lagging sales.

A bigger reason to worry is that in the last quarter of 2011, business spending on equipment and software grew at its slowest pace since the start of the economic recovery in the second half of 2009. This may imply that many companies are still nervous about the future and, despite strong profits, prefer to hoard cash instead of increasing capital spending (see chart 9). Although Eurozone debt problems, as well as reservations over the strength of economic growth in some emerging markets, add to this uncertainty, domestic policy issues remain the major concern for most businesses. For example, according to the latest survey by Chief Executive Magazine, in January, the CEO Confidence Index rose to its highest level in seven months. However, a hostile regulatory climate and political gridlock in Washington continue to unsettle investors. Small business owners, whose worries over weak sales have

---

1Source: The Autodata Corp.
2Source: R. L. Polk & Co.

---

Copyright © SigmaBleyzer, 2012. All rights reserved.
recently been subsiding, report a steady buildup in the burden of government regulations and red tape. On that note, government policies (in particular, lingering uncertainties over fiscal policy) are emerging as a big source of economic risk. For example, the latest Budget and Economic Outlook from the Congressional Budget Office estimates that, provided the current laws remain unchanged, the U.S. economy will grow by about 2% and 1% in 2012 and 2013, respectively, while this year the jobless rate will increase to 8.9% and to 9.2% at the end of 2013 (see chart 10). However, this dimmer economic outlook has a silver lining - the CBO believes that the federal budget deficit, which in 2012 is on track to exceed $1 trillion for the fourth year in a row, will be cut in half to 3.7% of GDP in 2013. Clearly, this scenario is optimistic and implies that policymakers face a number of difficult choices. However, a divided government and election paralysis leave little hope for bipartisan solutions, and policy uncertainties are likely to remain at elevated levels. A case in point is the extension of the payroll tax cut, which expires at the end of February. Although there is bipartisan backing to extend the payroll-tax break for the remainder of 2012, significant disagreements over how to offset budget costs of this extension still remain.

Employment

In December, the Texas jobless rate fell to 7.8% - its lowest level since July 2009 (see chart 11). This reduction in the unemployment rate is impressive given the backdrop of over 7% growth in the Texas labor force since the start of the recession (see chart 12). The faster growing workforce in Texas is a result of rapid population growth (since December 2007, the working-age population increased by over 7% in Texas versus approximately 5% in California) and a lower likelihood of Texans dropping out of the labor force. Indeed, over the past four years, the labor force participation rate, which, among other things, is a measure of how actively the unemployed are seeking employment, remained unchanged in Texas, while it fell by 2.5 percentage points in California. Healthier labor market conditions make Texans more upbeat about local job prospects. The fact that nonfarm employment in Texas has already surpassed its precrisis peak (August 2008) means it is easier to find a job in Texas compared to other large states. Nonfarm employment in Florida, California, New York and the nation as a whole is still 9.7%, 6.7%, 2.7% and 4.2% lower, respectively, than during the previous business-cycle peak (see chart 13).

Thanks to high energy prices and a rapid growth in shale gas production, Texas has the largest number of mining jobs in over two decades (see chart 14). That being said, solid job growth across most private industries points to a labor market recovery that extends beyond just the energy sector. Specifically, Texas saw relatively smaller losses in construction and manufacturing jobs compared to other large states (see chart 15). Indeed, the Texas construction sector entered the most recent recession with fewer jobs in residential building construction (just 8% at the end of 2007, compared to 17% in California) as well as a smaller

---

2 Assuming that in 2013 previous tax breaks are not extended and spending cuts of the Budget Control Act of 2011 take effect.
share of jobs in specialty trade construction1, including plumbers, electricians and carpenters. These jobs were hit particularly hard following the collapse of residential construction spending (see chart 16). Meanwhile, spending on utilities and road construction has recently been on an uptrend, which has helped shield heavy and civil engineering construction jobs (see chart 17). Since at the onset of the economic downturn, one in four constructions jobs in Texas was in heavy and civil engineering, the state’s construction employment numbers have fallen relatively less than other large states. For example, prior to the economic downturn, only one in ten construction jobs in Florida and California was either in highway and street construction or utility system construction.

Texas manufacturing jobs, which are at 90% of their 2007 level (versus 86% nationwide), were clearly helped by a smaller exposure to the construction industry. For example, at the end of 2007, Texas had just 10.7% of all manufacturing jobs in sectors particularly hit by the drop in construction spending, such as wood products manufacturing, manufacturing of building materials, and furniture manufacturing (see chart 18); meanwhile the share of such manufacturing jobs in Florida was nearly 15%. Second, at the beginning of the economic downturn, durable goods manufacturing in Texas had more jobs in machinery manufacturing (over 10% versus 8.6% nationwide), computer and electronics manufacturing (over 12% versus 9% in the U.S.) and fewer jobs in the auto industry (just 4% compared to 7% for the nation as whole). As a result, manufacturing jobs in Texas were less exposed to sagging demand for vehicles and enjoyed a rebound in overseas shipments of machinery and computers. Meanwhile, the state’s manufacturers of nondurable goods were helped by strength in the Texas petrochemical industry and a smaller share of jobs in the textile sector (1.8% in Texas versus 3.8% nationwide), where employment has shrunk by over a quarter since December 2007.

Lastly, the Texas labor market is enjoying a rebound in service-providing jobs – unlike the nation as a whole, the state now has more private sector service-providing jobs than at the beginning of the most recent recession (see chart 19). This trend can be partly explained by faster population growth in Texas6, which, coupled with an aging population, drives demand for healthcare services. Indeed, since December 2007, the number of healthcare and social assistance jobs in Texas has grown by nearly 18% versus just 7.8% in the U.S. overall (see chart 20). Demographic trends alone are just one side of the Texas labor market recovery. Indeed, stronger hiring in finance and professional and business services points to a robust uptick in overall business activity. About one in five private sector jobs, both in Texas and nationwide, is either in finance or professional and business services. Yet unlike the nation as a whole, where the number of jobs in finance and professional and business services is 6.4% (2.6% smaller than at the peak of the previous business cycle), Texas has just 1.6% fewer jobs in finance and as many jobs in professional and business services as in mid-2008.

### Monetary Policy and Asset Prices

Falling energy prices continue to keep consumer inflation in check (see chart 21), allowing the Federal Reserve to continue its current accommodative monetary policy. Indeed, during

---

1At the end of 2007, specialty trade constructors represented 52% of all construction jobs in Texas versus over 60% in many other large states. Meanwhile, about two thirds of over 1.9 million construction jobs lost during the past four years were in specialty trade construction.

2According to the U.S. Census Bureau, population in Texas grew by 1.7% in 2011, nearly twice as fast as for the nation as a whole.
its latest policy meeting, the Federal Open Market Committee announced it intends to maintain the federal funds rate at 0 to 1/4 percent at least through late 2014. Monetary policy will remain geared toward keeping long-term interest rates low and the Fed will be extending the average maturity of its securities portfolio, reinvesting proceeds from its holdings of mortgage-backed securities and rolling over maturing Treasury securities.

This ultra-loose monetary policy has facilitated record low mortgage rates – interest rates on conventional mortgages are now more than two percentage points lower than those seen during the pre-crisis housing boom (see chart 22). This, as well as the steady growth in private sector jobs, and more affordable homes, appears to have helped the housing market finally come to life. Indeed, both housing starts and sales have recently been getting stronger (see chart 23). In December 2011, housing inventories (both in Texas and nationwide) fell to their lowest level in four years – to a 6-month supply at the current sales pace. This should help add stability to property prices. After all, an increasing supply of distressed homes was a big factor behind declining house prices in 2011 (although Texas continued to outperform the nation as whole, see chart 24).